SHELBY ENERGY COOPERATIVE, INC.
AND SUBSIDIARY
KENTUCKY 30

CONSOLIDATED FINANCIAL REPORT

December 31, 2020

C O N T E N T S

JNM

Jones, Nale & Mattingly PLC

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Shelby Energy Cooperative, Inc. and Subsidiary
Shelbyville, Kentucky

We have audited the accompanying consolidated financial statements of Shelby Energy Cooperative, Inc. and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2020 and 2019, and the related consolidated statements of revenue and comprehensive income, changes in members' equities, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Certified Public Accountants and Advisors
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Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Shelby Energy Cooperative, Inc. and Subsidiary as of December 31, 2020 and 2019, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued a report dated March 2, 2021, on our consideration of Shelby Energy Cooperative, Inc. and Subsidiary's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering internal control over financial reporting and compliance.

Jones, Nale & Mattingly PLC

Louisville, Kentucky
March 2, 2021

SHELBY ENERGY COOPERATIVE, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS
December 31, 2020 and 2019

ASSETS	2020	2019
Utility Plant, at original cost:		
In service	$ 106,012,648	$ 102,363,915
Under construction	1,199,075	1,081,402
	107,211,723	103,445,317
Less accumulated depreciation	23,579,941	22,009,926
	83,631,782	81,435,391
Investments:		
Associated organizations	29,431,108	28,403,499
Goodwill	368,414	368,414
Total investments	29,799,522	28,771,913
Current Assets:		
Cash and cash equivalents	2,958,296	1,849,316
Accounts receivable, less allowance for 2020 of $457,172 and 2019 of $480,707	4,567,264	4,346,188
Unbilled revenue	174,218	57,028
Material and supplies, at average cost	632,794	726,526
Prepayments and other current assets	284,461	277,079
Total current assets	8,617,033	7,256,137
Deferred Debits	61,637	- -
Total assets	$ 122,109,974	$ 117,463,441

MEMBERS' EQUITIES AND LIABILITIES	2020	2019
Members' Equities:		
Patronage capital and retained earnings	$ 46,321,689	$ 44,931,212
Other equities	3,409,197	3,114,000
Accumulated other comprehensive income	306,710	324,752
Total members' equities	50,037,596	48,369,964
Long-Term Liabilities:		
Long-term debt, less current portion	61,545,016	58,899,853
Accumulated postretirement benefits	1,451,357	1,463,374
Total long-term liabilities	62,996,373	60,363,227
Current Liabilities:		
Current portion of long-term debt	2,956,175	2,213,099
Accounts payable	3,381,771	3,740,360
Consumer deposits	1,585,663	1,616,773
Accrued expenses	639,016	630,719
Total current liabilities	8,562,625	8,200,951
Consumer Advances for Construction	513,380	529,299
Total members' equities and liabilities	$ 122,109,974	$ 117,463,441

The Notes to Consolidated Financial Statements are an integral part of these statements.

SHELBY ENERGY COOPERATIVE, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF REVENUE AND COMPREHENSIVE INCOME
Years Ended December 31, 2020 and 2019

	2020	2019
Operating Revenues	$ 44,603,394	$ 48,432,816
Operating Expenses		
Cost of power and propane	30,353,584	34,081,124
Distribution - operations	2,716,446	2,230,710
Distribution - maintenance	2,750,879	2,936,837
Consumer accounts	645,809	629,929
Customer service and information	384,267	377,680
Administrative and general	924,055	1,058,357
Depreciation, excluding $211,862 in 2020 and $209,622 in 2019 charged to clearing accounts	3,771,155	3,583,688
Taxes, other than income	69,819	77,224
Interest on long-term debt	2,096,517	2,139,259
Other interest	26,655	47,486
Other deductions	32,687	84,826
Total cost of electric and propane service	43,771,873	47,247,120
Operating Margins	831,521	1,185,696
Nonoperating Margins		
Interest income	45,688	123,771
Unrelated business income tax	(82,193)	(128,960)
(Loss) on sale of equipment	(42,559)	(63,811)
	(79,064)	(69,000)
Patronage Capital Credits		
Generation and transmission	1,171,818	1,802,479
Other associated organizations	100,511	96,017
	1,272,329	1,898,496
Net Margins	2,024,786	3,015,192
Other Comprehensive Income		
Postretirement benefits (expense)	(18,042)	(18,042)
Net Margins and Comprehensive Income	$ 2,006,744	$ 2,997,150

The Notes to Consolidated Financial Statements are an integral part of these statements.

SHELBY ENERGY COOPERATIVE, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITIES
Years Ended December 31, 2020 and 2019

	Patronage Capital					Other	Accumulated Other Comprehensive	Total Members'
	Assigned	Assignable	Retirements	Unassigned	Total	Equities	Income	Equities
Balance - December 31, 2018	$ 48,606,725	$ 3,121,805	$ (10,018,463)	$ 624,680	$ 42,334,747	$ 2,902,401	$ 342,794	$ 45,579,942
Comprehensive income:								
Net margins		3,015,192			3,015,192			3,015,192
Assigned margins	2,583,482	(3,121,805)		538,323	- -			- -
Amortization							(18,042)	(18,042)
Total comprehensive income								2,997,150
Refunds of capital credits			(399,702)		(399,702)			(399,702)
Other equities			(320)	(18,705)	(19,025)	211,599		192,574
Balance - December 31, 2019	51,190,207	3,015,192	(10,418,485)	1,144,298	44,931,212	3,114,000	324,752	48,369,964
Comprehensive income:								
Net margins		2,024,786			2,024,786			2,024,786
Assigned margins	2,676,619	(3,015,192)		320,812	(17,761)	17,761		- -
Amortization							(18,042)	(18,042)
Total comprehensive income								2,006,744
Refunds of capital credits			(616,548)		(616,548)			(616,548)
Other equities						277,436		277,436
Balance - December 31, 2020	$ 53,866,826	$ 2,024,786	$ (11,035,033)	$ 1,465,110	$ 46,321,689	$ 3,409,197	$ 306,710	$ 50,037,596

The Notes to Consolidated Financial Statements are an integral part of these statements.

SHELBY ENERGY COOPERATIVE, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2020 and 2019

	2020	2019
CASH FLOWS FROM OPERATING ACTIVITIES		
Net margins	$ 2,024,786	$ 3,015,192
Adjustments to reconcile net margins to net cash provided by operating activities:		
Depreciation		
Charged to expense	3,771,155	3,583,688
Charged to clearing accounts	211,862	209,622
Patronage capital credits	(1,272,329)	(1,898,496)
Loss on disposition of general plant	42,559	63,811
Amortization of postretirement actuarial adjustment	(18,042)	(18,042)
Change in assets and liabilities:		
Receivables	(221,076)	5,355
Unbilled revenue	(117,190)	7,869
Material and supplies	93,732	(53,527)
Prepayments	(7,382)	(94,205)
Payables	(358,589)	767
Consumer deposits	(31,110)	20,765
Accrued expenses	8,297	89,184
Consumer advances for construction	(15,919)	45,937
Accumulated postretirement benefits	(12,017)	(17,875)
Net cash provided by operating activities	4,098,737	4,960,045
CASH FLOWS FROM INVESTING ACTIVITIES		
Increase in deferred debits	(61,637)	- -
Plant additions	(5,555,659)	(5,608,815)
Plant removal costs	(755,972)	(629,191)
Salvage recovered from retired plant	89,664	9,567
Receipts from investments, net	244,720	306
Net cash (used in) investing activities	(6,038,886)	(6,228,133)
CASH FLOWS FROM FINANCING ACTIVITIES		
Other equities	295,197	211,598
Advances of long-term debt	5,727,488	3,200,000
Payments on long-term debt	(2,339,248)	(4,892,157)
Retirement of patronage capital	(634,308)	(418,726)
Cushion of credit applied	- -	2,511,384
Net cash provided by financing activities	3,049,129	612,099
Net increase (decrease) in cash and cash equivalents	1,108,980	(655,989)
Cash and cash equivalents, beginning of year	1,849,316	2,505,305
Cash and cash equivalents, end of year	$ 2,958,296	$ 1,849,316

	2020	2019
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash payments for interest	$ 2,141,519	$ 2,166,643
Deferred debits in accounts payable	$ 32,046	$ - -

The Notes to Consolidated Financial Statements are an integral part of these statements.

Note 1. Summary of Significant Accounting Policies

Description of business

Shelby Energy Cooperative, Inc. and Subsidiary (Shelby Energy) maintains its records in accordance with the policies permitted by the Kentucky Public Service Commission (PSC) and the United States Department of Agriculture, Rural Utilities Service (RUS), which conform in all material respects with accounting principles generally accepted in the United States of America. The more significant of these policies are as follows:

Principals of consolidation

The consolidated financial statements include the accounts of Shelby Energy and Shelby Propane Plus, LLC (Propane Plus). Shelby Energy owns 100% of the member units of Propane Plus. All significant intercompany accounts and transactions have been eliminated.

Business activity

Shelby Energy provides distribution electric service to residential, business, and commercial consumers in 10 counties in central Kentucky. Propane Plus sells propane and related accessories to residential and commercial customers in central Kentucky. Shelby Energy provides overall business oversight to Propane Plus.

Estimates

The preparation of consolidated financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates used in the preparation of the consolidated financial statements.

Utility plant

Electric plant is stated at original cost, which is the cost when first dedicated to public service. Such amount includes applicable supervisory and overhead cost including any construction period interest and taxes. There was no interest required to be capitalized during the year.

The cost of maintenance and repairs, including renewals of minor items of property, is charged to operating expense. The cost of replacement of depreciable property units, as distinguished from minor items, is charged to electric plant. The units of property replaced or retired, including cost of removal net of any salvage value, is charged to accumulated depreciation.

Propane Plus's fixed assets consist primarily of propane tanks located on customers' premises, bulk tanks, trucks used for delivery, and buildings and office equipment.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies (Continued)

Utility plant (continued)

The major classifications of utility plant in service consist of the following as of December 31, 2020 and 2019:

	2020	2019
Distribution plant	$ 98,244,977	$ 94,618,875
General plant	4,498,185	4,717,363
Subtotal electric plant	$ 102,743,162	$ 99,336,238
Propane tanks on customer premises	$ 1,193,012	$ 1,111,117
Bulk tanks	447,229	387,195
Delivery and other trucks	1,027,752	951,352
Land and buildings	484,826	465,442
Office and other equipment	116,667	112,571
Subtotal propane plant	$ 3,269,486	$ 3,027,677
Utility Plant, at original cost	$ 106,012,648	$ 102,363,915

Depreciation

Provision has been made for depreciation on the basis of the estimated lives of assets, using the straight-line method. Distribution plant depreciation is based on a composite rate of 3.48% per annum. General plant rates are as follows:

Structures and improvements	2.50%
Transportation equipment	10.50 - 20.00%
Other general plant	5.00 - 14.00%

Propane Plus's depreciation is computed using the straight-line method over the useful lives of its assets.

Goodwill

Goodwill was recorded in connection with the purchase of the remaining 50% interest of Propane Plus from an unrelated party on June 30, 2000. The excess of the payment price over the value of assets acquired has been recorded as goodwill. Propane Plus tests goodwill for impairment when a triggering event occurs that indicates the fair value of the entity may be below its carrying value. As of December 31, 2020 and 2019, management does not believe an impairment exists.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies (Continued)

Cash and cash equivalents

Shelby Energy considers all short-term, highly liquid investments with original maturities of three months or less to be cash equivalents. Shelby Energy maintains cash deposits in financial institutions in excess of the amounts insured by the Federal Deposit Insurance Corporation (FDIC). As of December 31, 2020 and 2019, the financial institutions reported deposits in excess of the $250,000 FDIC insured limit several times during the audit period. Deposits in excess of the FDIC limit are 100% secured with collateral at the financial institution.

Accounts receivable

Accounts receivable consists of amounts due for sales of electric energy and propane. Accounts receivable are recorded at their net realizable value consisting of the carrying amount less an allowance for uncollectible accounts. Shelby Energy and Propane Plus use the allowance method to account for uncollectible accounts receivable balances. Management charges off uncollectible receivables to the allowance when it is determined the amounts will not be realized.

Materials and supplies

Shelby Energy and Propane Plus value materials and supplies at the lower of average cost or net realizable value.

Propane inventory

Propane Plus purchases all of its propane requirements from unrelated parties through Kentucky Propane Plus, LLC. Propane is delivered to bulk tanks owned by Propane Plus, then delivered to customers on an as needed basis. Propane is valued at the lower of average cost or net realizable value.

Sales tax

Shelby Energy and Propane Plus are required to collect, on behalf of the Commonwealth of Kentucky, sales taxes based on 6 percent of gross sales from non-residential consumers, a 3 percent school tax from certain counties on most gross sales, and franchise fees in certain cities. Shelby Energy's policy is to exclude sales tax from revenue when collected and expenses when paid and instead, record collection and payment of sales taxes through a liability account.

Cost of power

Shelby Energy is one of 16 members of East Kentucky Power Cooperative (East Kentucky). Under a wholesale power agreement, Shelby Energy is committed to purchase its electric power and energy requirements from East Kentucky until 2051. The rates charged by East Kentucky are subject to approval of the PSC. The cost of purchased power is recorded monthly, during the period in which the energy is consumed, based upon billings from East Kentucky. There are certain surcharges, clauses, and credits that East Kentucky includes to Shelby Energy that are passed on to consumers using a methodology prescribed by the PSC.

Note 1. Summary of Significant Accounting Policies (Continued)

Advertising

Shelby Energy and Shelby Propane expense advertising costs as incurred. Advertising expense totaled $22,257 and $12,684 for the years ended December 31, 2020 and 2019, respectively.

Comprehensive income

Comprehensive income includes both net margin and other comprehensive income. Other comprehensive income represents the change in funded status of the accumulated postretirement benefit obligation.

Risk management

Shelby Energy and Propane Plus are exposed to various forms of losses of assets associated with, but not limited to, fire, personal liability, theft, vehicular accidents, errors and omissions, fiduciary responsibility, workers compensation, etc. Each of these areas is covered through the purchase of commercial insurance.

Credit risk

Shelby Energy grants credit to residents within its service territory. Concentrations of credit risk with respect to accounts receivables are limited due to its large number of customers.

Income tax status

Shelby Energy qualifies as a tax-exempt organization under Section 501(c)(12) of the Internal Revenue Code. However, income from certain activities not directly related to Shelby Energy's tax-exempt purpose is subject to taxation as unrelated business income. Shelby Energy is responsible for reporting unrelated business income associated with its wholly owned subsidiary Propane Plus, a limited liability company.

Shelby Energy's accounting policy provides that a tax expense/benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. Shelby Energy has no uncertain tax positions resulting in an accrual of tax expense or benefit.

Shelby Energy's Federal Return of Organization Exempt from Income Tax is subject to possible examination by taxing authorities until the expiration of related statutes of limitations on the return, which is generally three years.

Management services

Propane Plus is one of 4 propane companies that contracts with an individual who manages the day to day operations of each propane company and arranges for the purchase of bulk propane. Propane Plus shares the cost equally for the labor, benefits, and other costs of this manager.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies (Continued)

Pension accounting

In May 2017, the Financial Accounting Standards Board (FASB) issued ASU 2017-07, *Improving the Presentation of Net periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. The standard specifies how the amount of pension costs and costs for post-retirement benefits other than pensions (PBOP) should be presented on the income statement under accounting principles generally accepted in the United States of America, and what components of those costs are eligible for capitalization in assets. This standard is effective for years beginning after December 15, 2018. The Federal Energy Regulatory Commission (FERC) issued Docket No. AI18-1-000 that allowed jurisdictional public utilities to continue to record PBOP costs in their entirety, less amounts capitalized, without change. Pension and PBOP costs are made up of several components: service cost, interest cost, actual return on plan assets, gain or loss, amortization of prior service cost or credit, and amortization of FASB Accounting Standards Codification (ASC) Subtopic 715-30. Though pension and PBOP costs are computed using the aggregate total of these various components, the PSC's longstanding policy is to consider the amount as a singular cost to the employer. This cost is calculated based on ASC 715 and reported as an expense under net margins from continuing operations.

Recent accounting pronouncements

In February 2016, the FASB issued ASU 2016-02, *Leases*. The standard requires all leases with lease terms over 12 months to be capitalized as a right-of-use asset and lease liability on the balance sheet at the date of lease commencement. Leases will be classified as either finance or operating. This distinction will be relevant for the pattern of expense recognition in the statement of revenue and comprehensive income. This standard will be effective for the year ending December 31, 2022.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments-Credit Losses.* The standard requires a financial asset (including trade receivables) measured at amortized cost basis to be presented at the net amount expected to be collected. Thus, the statement of revenue and comprehensive income will reflect the measurement of credit losses for newly recognized financial assets as well as the expected increases or decreases of expected credit losses that have taken place during the period. This standard will be effective for the year ending December 31, 2023.

Shelby Energy is currently in the process of evaluating the impact of the adoption of these ASUs on the consolidated financial statements.

Reclassifications

Certain amounts presented in the 2019 consolidated financial statements have been reclassified to conform to the 2020 presentation.

Subsequent events

Management has evaluated subsequent events through March 2, 2021, the date the consolidated financial statements were available to be issued.

Note 2. Revenue Recognition

Revenue from contracts

Shelby Energy is engaged in the distribution and sale of electricity to residential and commercial customers in 10 counties in central Kentucky. Revenue from these activities is generated from tariffs approved by the PSC. Shelby Energy satisfies their performance obligation upon the delivery of electricity to customers. Revenue is recognized over-time as the customer simultaneously receives and consumes the benefits provided by Shelby Energy. The amount of revenue recognized is the billed volume of electricity multiplied by a tariff rate per-unit of energy, plus any applicable fixed or additional regulatory charges. Customers are billed monthly and outstanding amounts are typically due within 15 days of the date of the bill. Revenue for pole attachments are invoiced at the end of the year. The performance obligation is satisfied ratably over the time of the contract. These amounts are recorded as a receivable at the time of invoicing.

Propane Plus is primarily engaged in the sale of propane to residential and commercial customers in central Kentucky. Propane Plus has standard prices for regular customers but also enters into contracts with some customers for an agreed-upon fixed price per gallon. Customers request propane as needed, and Propane Plus recognizes revenue at the point in time when the propane is delivered. The amount of revenue recognized is the volume of propane delivered multiplied by the price per gallon. Customers are billed at the point of sale and outstanding amounts are typically due within 30 days of the date of the bill.

Significant judgements

Shelby Energy recognizes unbilled electric revenue as a result of customers' bills being generated throughout the month rather than at the end of the month. Unbilled revenues for the month are calculated by taking the difference between the billing register and the estimated sales based on the kilowatt hours of electricity purchased less an estimated amount of line loss based on the prior 12 months. Any difference between estimated and actual revenues is adjusted the following month when the previous unbilled estimate is reversed and actual billings are generated. This method of revenue recognition presents fairly, the Shelby Energy's transfer of electricity to customers as the amount recognized is based on actual and estimated volumes delivered and the tariff rate per-unit of energy and any applicable fixed charges as set by the PSC. Propane Plus recognizes revenue at the point when customer orders are delivered, therefore, there are no unbilled or overbilled amounts to recognize.

Performance obligations

Shelby Energy and Propane Plus customers generally have no minimum purchase commitments. Shelby Energy and Propane Plus recognize revenue as each performance obligation is satisfied. Performance obligations are limited to the service requested and received to date. Accordingly, there are no unsatisfied performance obligations to recognize as of December 31, 2020 and 2019.

Note 2. Revenue Recognition (Continued)

Disaggregation of revenue

The following table shows Shelby Energy and Propane Plus revenues from contracts with customers disaggregated by customer class, for the years ended December 31:

	2020	2019
Residential	$ 25,436,200	$ 26,648,209
Large Industrial	9,424,872	10,742,617
Commercial	6,877,500	7,845,985
Public Lights	57,967	56,061
Other	532,500	825,037
Propane	2,274,355	2,314,907
Total	$ 44,603,394	$ 48,432,816

Contract assets and liabilities

Contract assets include unbilled revenues. Contract liabilities include consumer deposits. The balances in contract assets and liabilities were as follows as of December 31:

	2020	2019	2018
Contract assets	$ 174,218	$ 57,028	$ 64,897
Contract liabilities	$ 1,585,663	$ 1,616,773	$ 1,596,009

Note 3. Investments in Associated Organizations

Investments in associated organizations consist of the following as of December 31:

	2020	2019
East Kentucky, patronage capital	$ 27,422,988	$ 26,460,048
CFC CTCs	596,599	628,197
CFC patronage capital	366,744	342,776
CFC member capital securities	50,000	25,000
Other associated organizations	874,895	814,151
Economic development loans	119,882	133,327
Total	$ 29,431,108	$ 28,403,499

Note 3. Investments in Associated Organizations (Continued)

Shelby Energy records patronage capital assigned by associated organizations in the year in which such assignments are received. The Capital Term Certificates (CTCs) of CFC are recorded at cost. The CTCs were purchased from CFC as a condition of obtaining long-term financing. The CTCs bear interest at 3.00% and 5.00% and are scheduled to mature at varying times from 2020 to 2080. Shelby Energy purchased $25,000 of CFC member capital securities in April 2014 and $25,000 of CFC member capital securities in November 2020. The securities bear interest at 5.00% and mature 30 years from the issue date and are callable by CFC, in whole or in part, at any time after ten years from the issue date at 100 percent of the principal amount to be redeemed together with accrued and unpaid interest to the redemption date.

Note 4. Patronage Capital

Under provisions of the long-term debt agreement, return to patrons of capital contributed by them is limited to amounts which would not allow the total equities and margins to be less than 30.00% of total assets, except that distributions may be made to estates of deceased patrons. The debt agreement provides, however, that should such distributions to estates not exceed 25.00% of the net margins for the next preceding year, Shelby Energy may distribute the difference between 25.00% and the payments made to such estates. Shelby Energy's equity at December 31, 2020 and 2019 was 41.01% and 41.21% of total assets, respectively.

Note 5. Long-Term Debt

All assets of Shelby Energy, except vehicles, are pledged as collateral on the long-term debt to RUS, Federal Financing Bank (FFB), and CFC under a joint mortgage agreement. The long-term debt is due in quarterly and monthly installments of varying amounts through 2052. As of December 31, 2020 and 2019, there was $11,119,000 and $15,919,000 of FFB loan funds unadvanced, respectively. These funds will be used for future plant additions.

In May 2020, Shelby Energy qualified for and received a loan pursuant to the Paycheck Protection Program (PPP), a program implemented by the United States Small Business Administration (SBA) under the Coronavirus Aid, Relief, and Economic Security Act, from a qualified lender (the PPP Loan). The PPP Loan bears interest at a fixed rate of 1.00% per annum, with the first six months of interest deferred, has a term of two years, and is unsecured and guaranteed by the SBA. The principal amount of the PPP Loan is subject to forgiveness upon Shelby Energy's request to the extent that the PPP Loan proceeds are used to pay expenses permitted by the PPP, including payroll costs, covered rent and mortgage obligations, and covered utility payments incurred by Shelby Energy. Shelby Energy is accounting for the loan proceeds as debt in accordance with ASC 470. As such, Shelby Energy will recognize the forgiveness of debt in accordance with RUS guidance once the conditions for loan forgiveness have been substantially met. Shelby Energy applied for forgiveness of the PPP Loan and received notice from the SBA in January 2021 that the entire loan of $927,488 was forgiven.

Note 5. Long-Term Debt (Continued)

Long-term debt consists of the following as of December 31:

	2020	2019
Citizens Union Bank, 1.00% fixed rate note	$ 927,488	$ - -
RUS, 2.00% to 4.50% fixed rate notes	1,372,790	1,467,770
FFB, 2.30% to 4.79% fixed rate notes	46,165,292	42,666,131
CFC:		
3.65% to 6.65% fixed rate notes	1,714,950	1,894,760
Refinanced RUS loans, 3.20% to 5.05% fixed rate notes	14,320,671	15,084,291
	64,501,191	61,112,952
Less current portion	2,956,175	2,213,099
Long-term portion	$ 61,545,016	$ 58,899,853

As of December 31, 2020, the annual principal portion of long-term debt outstanding for the next five years and thereafter are as follows:

2021	$ 2,956,175
2022	2,720,660
2023	2,496,537
2024	2,575,064
2025	2,648,264
Thereafter	51,104,491
	$ 64,501,191

Note 6. Short-Term Borrowings

Shelby Energy has a short-term line of credit of $6,000,000 available from CFC. There were no advances against the line of credit as of December 31, 2020 and 2019. The line of credit matures in January 2022.

Note 7. Pension Plans

All eligible employees of Shelby Energy participate in the NRECA Retirement and Security Plan (RS Plan), a defined benefit pension plan qualified under section 401 and tax exempt under section 501(a) of the Internal Revenue Code. It is a multiemployer plan under the accounting standards. The Plan sponsor's identification number is 53-0116145 and the Plan Number is 333. Eligible employees include employees hired prior to September 2, 2009. Non-eligible employees are those hired after September 2, 2009. A unique characteristic of a multiemployer plan compared to a single employer plan is that all plan assets are available to pay benefits of any plan participant. Separate asset accounts are not maintained for participating employers. This means that assets contributed by one employer may be used to provide benefits to employees of other participating employers.

Note 7. Pension Plans (Continued)

Shelby Energy's contributions to the RS Plan in 2020 and 2019 represent less than 5.00% of the total contributions made to the plan by all participating employers. Shelby Energy made contributions to the plan of $155,716 in 2020 and $173,818 in 2019. There have been no significant changes that affect the comparability of 2020 and 2019. Employees hired after September 2, 2009 can only participate in the NRECA 401(k) plan. Employer contributions to the 401(k) plan amounted to $192,463 for 2020 and $148,498 for 2019.

In the RS Plan, a zone status determination is not required, and therefore not determined, under the Pension Protection Act (PPA) of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the RS Plan was over 80.00% funded at January 1, 2020 and 2019 based on the PPA funding target and PPA actuarial value of assets on those dates. Because the provisions of the PPA do not apply to the RS Plan, funding improvement plans and surcharges are not applicable. Future contribution requirements are determined each year as part of the actuarial valuation of the plan and may change as a result of plan experience.

At the December 2012 meeting of the I&FS Committee of the NRECA Board of Directors, the Committee approved an option to allow participating cooperatives in the Retirement Security (RS) Plan (a defined benefit multiemployer pension plan) to make a prepayment and reduce future required contributions. The prepayment amount is a cooperative share, as of January 1, 2013, of future contributions required to fund the RS Plan's unfunded value of benefits earned to date using Plan actuarial valuation assumptions. The prepayment amount will typically equal approximately 2.5 times a cooperative's annual RS Plan required contribution as of January 1, 2013. After making the prepayment, for most cooperatives the billing rate is reduced by approximately 25.00%, retroactive to January 1, 2013. The 25.00% differential in billing rates is expected to continue for approximately 15 years. However, changes in interest rates, asset returns and other plan experience different from that expected, plan assumptions changes, and other factors may have an impact on the differential in billing rates and the 15 year period. During the year ended December 31, 2013 Shelby Energy made the prepayment contribution.

Propane Plus has a profit-sharing plan of 14.00% of net profits before the pension amount, where managers receive 5.00%, assistant managers receive 1.50%, employees receive 5.00%, and the chief operating officer receives the remaining 2.50%. The pension contribution for 2020 was $12,946 and 2019 was $10,887.

Note 8. Postretirement Benefits

Shelby Energy sponsors a noncontributory defined benefit plan that provides medical insurance coverage to retired employees hired prior to July 1, 1996. Employees hired after July 1, 1996 are not eligible to participate. The plan calls for benefits to be paid at retirement based primarily upon years of service with Shelby Energy. For measurement purposes, an annual rate of increase of 7.00% in 2020, then decreasing by .25% per year until 4.00% per year, in the per capita cost of covered healthcare benefit was assumed. The discount rate used in determining the accumulated postretirement benefit obligation was 4.50% in 2020 and 2019. There have been no significant changes that affect the comparability of 2020 and 2019.

Note 8. Postretirement Benefits (Continued)

The funded status of the plan was as follows as of December 31, 2020 and 2019:

	2020	2019
Projected benefit obligation	$ (1,451,357)	$ (1,463,374)
Plan assets at fair value	- -	- -
Funded status (deficit)	$ (1,451,357)	$ (1,463,374)

The components of net periodic postretirement benefit cost are as follows as of and for the year ended December 31, 2020 and 2019:

	2020	2019
Benefit obligation at beginning of year	$ 1,463,374	$ 1,481,249
Components of net periodic benefit cost:		
Service cost	61,777	61,103
Interest cost	65,581	66,254
Net periodic benefit cost	127,358	127,357
Benefits paid	(139,375)	(145,232)
Benefit obligation at end of year	$ 1,451,357	$ 1,463,374
Amounts recognized in the balance sheet consists of:		
Accumulated Postretirement Benefits	$ 1,451,357	$ 1,463,374
Amounts included in other comprehensive income:		
Unrecognized actuarial gain	$ 306,710	$ 324,752
Effect of 1% increase in the health care trend:		
Postemployment benefit obligation	$ 1,545,000	
Net periodic benefit cost	$ 136,000	

Projected retiree benefit payments for the next five years are expected to be as follows: 2021 - $115,000; 2022 - $122,000; 2023 - $113,000; 2024 - $87,000; 2025 - $65,000.

Note 9. Commitments

Shelby Energy has various other agreements outstanding with local contractors. Under these agreements, the contractors will perform certain construction, maintenance, and other work at specified hourly rates or unit cost, or on an as needed basis. The duration of these contracts are one to three years.

Note 10. Related Party Transactions

Several of the Directors of Shelby Energy, its President and CEO, and another employee are on the boards of directors of various associated organizations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11. Labor Force

Approximately 35.00% of Shelby Energy's labor force is subject to a collective bargaining agreement. A three-year agreement was negotiated and approved for the period starting September 2018 through September 2021 between Shelby Energy and the International Brotherhood of Electric Workers (IBEW).

Note 12. Environmental Contingency

Shelby Energy from time to time is required to work with and handle PCBs, herbicides, automotive fluids, lubricants, and other hazardous materials in the normal course of business. As a result, there is the possibility that environmental conditions may arise which would require Shelby Energy to incur cleanup costs. The likelihood of such an event, or the amount of such costs, if any, cannot be determined at this time. However, management does not believe such costs, if any, would materially affect Shelby Energy's financial position or its future cash flows.

Note 13. Contingencies

Shelby Energy, on occasion, is involved in litigation arising in the normal course of business. While the results of such litigation cannot be predicted with certainty, management, based upon advice of counsel, believes that the final outcome will not have a material adverse effect on the consolidated financial statements.

Note 14. Uncertainties

Since March 2020, local, U.S., and world governments have encouraged self-isolation to curtail the spread of the global pandemic, coronavirus disease (COVID-19), by mandating temporary work stoppage in many sectors and imposing limitations on travel and size and duration of group meetings. Most industries are experiencing disruption to business operations and the impact of reduced consumer spending. There is unprecedented uncertainty surrounding the duration of the pandemic, its potential economic ramifications, and any government actions to mitigate them. Accordingly, while management cannot quantify the financial and other impact to Shelby Energy and Propane Plus as of March 2, 2021, management believes that a material impact on Shelby Energy and Propane Plus's financial position and results of future operations is reasonably possible.

INDEPENDENT AUDITOR'S REPORT ON SUPPLEMENTARY INFORMATION

To the Board of Directors
Shelby Energy Cooperative, Inc. and Subsidiary
Shelbyville, Kentucky

We have audited the consolidated financial statements of Shelby Energy Cooperative, Inc. and Subsidiary as of and for the years ended December 31, 2020 and 2019, and our report thereon dated March 2, 2021, which expressed an unmodified opinion on those consolidated financial statements, appears on pages 1 and 2. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating supplementary information shown on pages 20 and 21 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Jones, Nale & Mattingly PLC

Louisville, Kentucky
March 2, 2021

Certified Public Accountants and Advisors
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SHELBY ENERGY COOPERATIVE, INC. AND SUBSIDIARY

CONSOLIDATING BALANCE SHEET
December 31, 2020

Assets	Shelby Energy	Propane Plus	Eliminations	Consolidated
Utility Plant, at original cost:				
In service	$ 102,743,162	$ 3,269,486	$ - -	$ 106,012,648
Under construction	1,199,075	- -	- -	1,199,075
	103,942,237	3,269,486	- -	107,211,723
Less accumulated depreciation	21,684,507	1,895,434	- -	23,579,941
	82,257,730	1,374,052	- -	83,631,782
Investments:				
Associated organizations	29,431,108	- -	- -	29,431,108
Goodwill, net of amortization	- -	368,414	- -	368,414
Investment in Subsidiary	2,884,575	- -	(2,884,575)	- -
Total investments	32,315,683	368,414	(2,884,575)	29,799,522
Current Assets:				
Cash and cash equivalents	2,136,838	821,458	- -	2,958,296
Accounts receivable, less allowance for Energy of $441,172 and Propane of $16,000	4,341,956	225,308	- -	4,567,264
Unbilled revenue	174,218	- -	- -	174,218
Material and supplies, at average cost	478,544	154,250	- -	632,794
Prepayments and other current assets	234,261	50,200	- -	284,461
Total current assets	7,365,817	1,251,216	- -	8,617,033
Deferred Debits	61,637	- -	- -	61,637
Total assets	$ 122,000,867	$ 2,993,682	$ (2,884,575)	$ 122,109,974
Members' Equities and Liabilities				
Members' Equities:				
Capital investment	$ - -	$ 487,677	$ (487,677)	$ - -
Patronage capital and retained earnings	46,321,689	2,396,898	($2,396,898)	46,321,689
Other equities	3,409,197	- -	- -	3,409,197
Accumulated other comprehensive income	306,710	- -	- -	306,710
Total members' equities	50,037,596	2,884,575	(2,884,575)	50,037,596
Long-Term Liabilities:				
Long-term debt, less current portion	61,545,016	- -	- -	61,545,016
Accumulated postretirement benefits	1,451,357	- -	- -	1,451,357
Total long-term liabilities	62,996,373	- -	- -	62,996,373
Current Liabilities:				
Current portion of long-term debt	2,956,175	- -	- -	2,956,175
Accounts payable	3,381,771	- -	- -	3,381,771
Consumer deposits	1,537,884	47,779	- -	1,585,663
Accrued expenses	577,688	61,328	- -	639,016
Total current liabilities	8,453,518	109,107	- -	8,562,625
Consumer Advances for Construction	513,380	- -	- -	513,380
Total members' equities and liabilities	$ 122,000,867	$ 2,993,682	$ (2,884,575)	$ 122,109,974

SHELBY ENERGY COOPERATIVE, INC. AND SUBSIDIARY

CONSOLIDATING STATEMENT OF REVENUE AND COMPREHENSIVE INCOME
Year Ended December 31, 2020

	Shelby Energy	Propane Plus	Eliminations	Consolidated
Operating Revenues	$ 42,329,039	$ 2,274,355	$ - -	$ 44,603,394
Operating Expenses				
Cost of purchases	29,533,708	819,876	- -	30,353,584
Distribution - operations	2,185,395	531,051	- -	2,716,446
Distribution - maintenance	2,750,879	- -	- -	2,750,879
Consumer accounts	509,817	135,992	- -	645,809
Customer service and information	384,267	- -	- -	384,267
Administrative and general	768,401	155,654	- -	924,055
Depreciation, excluding $211,862 charged to clearing accounts	3,578,004	193,151	- -	3,771,155
Taxes, other than income	59,105	10,714	- -	69,819
Interest on long-term debt	2,096,517	- -	- -	2,096,517
Other interest	26,655	- -	- -	26,655
Other deductions	32,687	- -	- -	32,687
Total cost of service	41,925,435	1,846,438	- -	43,771,873
Operating Margins	403,604	427,917	- -	831,521
Nonoperating Margins				
Interest income	43,098	2,590	- -	45,688
Unrelated business income tax	(82,193)	- -	- -	(82,193)
(Loss) on sale of equipment	(42,559)	- -	- -	(42,559)
Investment in subsidiary	430,507	- -	(430,507)	- -
	348,853	2,590	(430,507)	(79,064)
Patronage Capital Credits				
Generation and transmission	1,171,818	- -	- -	1,171,818
Other associated organizations	100,511	- -	- -	100,511
	1,272,329	- -	- -	1,272,329
Net Margins	2,024,786	430,507	(430,507)	2,024,786
Other Comprehensive Income				
Postretirement benefits (expense)	(18,042)	- -	- -	(18,042)
Net Margins and Comprehensive Income	$ 2,006,744	$ 430,507	$ (430,507)	$ 2,006,744

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors
Shelby Energy Cooperative, Inc. and Subsidiary
Shelbyville, Kentucky

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Shelby Energy Cooperative, Inc. and Subsidiary (the Corporation), which comprise the consolidated balance sheet as of December 31, 2020 and the related consolidated statements of revenue and comprehensive income, changes in members' equities and cash flows for the year then ended, and related notes to the consolidated financial statements, and have issued our report thereon dated March 2, 2021.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered the Corporation's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control. Accordingly, we do not express an opinion on the effectiveness of the Corporation's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's consolidated financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Corporation's consolidated financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Jones, Nale & Mattingly PLC

Louisville, Kentucky
March 2, 2021

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Jones, Nale & Mattingly PLC

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH ASPECTS OF CONTRACTUAL AGREEMENTS AND REGULATORY REQUIREMENTS FOR ELECTRIC BORROWERS

To the Board of Directors
Shelby Energy Cooperative, Inc. and Subsidiary
Shelbyville, Kentucky

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of Shelby Energy Cooperative, Inc. and Subsidiary (the Corporation), which comprise the consolidated balance sheet as of December 31, 2020, and the related consolidated statements of revenue and comprehensive income, changes in members' equities, and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated March 2, 2021. In accordance with *Government Auditing Standards*, we have also issued our report dated March 2, 2021, on our consideration of the Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. No reports other than the reports referred to above and our schedule of findings and recommendations related to our audit have been furnished to management.

In connection with our audit, nothing came to our attention that caused us to believe that the Corporation failed to comply with the terms, covenants, provisions, or conditions of their loan, grant, and security instruments as set forth in 7 CFR Part 1773, *Policy on Audits of Rural Utilities Service Borrowers and Grantees*, §1773.33, insofar as they relate to accounting matters as enumerated below. However, our audit was not directed primarily toward obtaining knowledge of noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the Corporation's noncompliance with the above-referenced terms, covenants, provisions, or conditions of the contractual agreements and regulatory requirements, insofar as they relate to accounting matters. In connection with our audit, we noted no matters regarding the Corporation's accounting and records to indicate that the Corporation did not:

- Maintain adequate and effective accounting procedures;
- Utilize adequate and fair methods for accumulating and recording labor, material, and overhead costs, and the distribution of these costs to construction, retirement, and maintenance or other expense accounts;
- Reconcile continuing property records to the controlling general ledger plant accounts;
- Clear construction accounts and accrue depreciation on completed construction;
- Record and properly price the retirement of plant;
- Seek approval of the sale, lease, or transfer of capital assets and disposition of proceeds for the sale or lease of plant, material, or scrap;
- Maintain adequate control over material and supplies;

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- Prepare accurate and timely Financial and Operating Reports;
- Obtain written RUS approval to enter into any contract for the management, operation, or maintenance of the borrower's system if the contract covers all or substantially all of the electric system;
- Disclose material related party transactions in the consolidated financial statements, in accordance with requirements for related parties in generally accepted accounting principles;
- Record depreciation in accordance with RUS requirements ("See RUS Bulletin 183-1, Depreciation Rates and Procedures");
- Comply with the requirements for the detailed schedule of deferred debits and deferred credits, which are listed below; and
- Comply with the requirements for the detailed schedule of investments, which are listed below.

The deferred debits are as follows:

NISC conversion costs	$ 61,637

The deferred credits are as follows:

Consumer advances for construction	$ 513,380

Shelby Energy is a 100% owner of a subsidiary, Shelby Propane Plus, LLC, which is engaged in the distribution sales of propane gas in and around the areas in which Shelby Energy provides electric service. The activity of the subsidiary is as follows for the year ended December 31, 2020:

	Investment
Beginning balance	$ 2,525,921
Net income	430,507
Distributions	(71,853)
Ending balance	$ 2,884,575

The purpose of this report is solely to communicate, in connection with the audit of the consolidated financial statements, on compliance with aspects of contractual agreements and the regulatory requirements for electric borrowers based on the requirements of 7 CFR Part 1773*, Policy on Audits of Rural Utilities Service Borrowers and Grantees*. Accordingly, this report is not suitable for any other purpose.

Jones, Nale & Mattingly PLC

Louisville, Kentucky
March 2, 2021